

## Internal Revenue Service

## Department of the Treasury

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Person to Contact:

Telephone Number:

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### Legend

X =

A =

B =

C =

D =

E =

F =

G =

H =

I =

J =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

x =

y =

**Dear**

This responds to a letter dated April 3, 2002, together with subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

## FACTS

The information submitted states that X was formed on Date 1 and timely filed an S election effective on Date 1. A was the sole shareholder of X from Date 1 to Date 2. On Date 2, A sold x shares of stock in X to B, a nonresident alien. On Date 3, at a meeting with A's accountant, A and B learned that the transfer of stock to B terminated X's S election. On Date 4, B transferred y shares of X stock to each of B's children (C, D, E, F, G, H, I and J), all of whom are U.S. citizens.

X represents that there was no intent to knowingly terminate X's S election, and that the events that resulted in the termination were not motivated by tax avoidance or retroactive tax planning. X and X's shareholders have agreed to make any adjustments that the Secretary may require, consistent with the treatment of X as an S corporation.

## LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(C) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have a nonresident alien as a shareholder.

Section 1362(d)(2) provides that an election under §1362(a) shall be terminated whenever (at any time on or after the 1<sup>st</sup> day of the 1<sup>st</sup> taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b), or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and

each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, such corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts and the representations submitted, we conclude that X's S election terminated on Date 2 when the X stock was sold to B. We further conclude that the termination was inadvertent within the meaning of § 1362(f). Accordingly, we hold that under the provisions of § 1362(f), X will be treated as an S corporation from Date 2, and thereafter, provided that X's election was otherwise valid and was not terminated under § 1362(d). In determining their respective income tax liabilities, the shareholders of X must include their pro rata share of the separately and nonseparately computed items of X as provided in §1366, make adjustments to stock basis as provided in § 1367, and take into account any distributions made by X as provided by § 1368. For purposes of the preceding sentence C, D, E, F, G, H, I and J each will be treated as owning y shares of X stock during the period from Date 2 through Date 4.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,  
Matthew Lay  
Acting Chief, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes